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Levi Strauss (M) Sdn Bhd v Ketua Pengarah Kastam, Malaysia

HIGH COURT (KUALA LUMPUR) — APPLICATION FOR JUDICIAL REVIEW NO R2–25–213 OF 2010
ZAWAWI SALLEH J
5 MAY 2011

Administrative Law — Judicial review — Application for — Review of decision of Ketua Pengarah Kastam Malaysia to impose additional customs duty and sales tax by including royalty payments paid by applicant — Whether royalty payments should be regarded as adjustment item for purposes of calculating customs value — Customs (Rules of Valuation) Regulations 1999 regs 4 & 5

Statutory Interpretation — Construction of statutes — Purposive approach — Taxing statute — Approach by courts — Whether court under duty to adopt purposive approach in interpreting taxing statute — Customs (Rules of Valuation) Regulations 1999 regs 4 & 5

Pursuant to a licence agreement between Levi Strauss and Co and Levi Strauss (M) Sdn Bhd ('the applicant'), which was in the business of manufacturing apparels, the applicant was granted the right to use certain trademarks and trade names on its apparels. In consideration of this right the applicant was required to pay various sums of money ('royalty payments') to Levi Strauss and Co. The royalty payments were payable for all products sold by the applicant notwithstanding whether they were sourced locally or imported and whether sourced from related or non-related third parties. The Ketua Pengarah Kastam Malaysia ('the respondent') adjusted the customs value of all products purchased by the applicant between the year 2000 and 2001 ('the material period') by including the royalty payments paid by the applicant to Levi Strauss and Co. The respondent relied on regs 4 and 5 of the Customs (Rules of Valuation) Regulations 1999 ('the Regulations') to arrive at the adjusted customs value of the goods purchased by the applicant for the material period. The applicant filed a judicial review application against the decision of the respondent to impose an additional customs duty of RM3,699,706.71 and an additional sales tax of RM2,219,824.02 on the goods purchased by the applicant during the material period. The applicant argued that the royalty payments should not be included in the calculation of the customs value of the goods purchased by the applicant because they were not a condition for the applicant to sell the goods in Malaysia, as was required under reg 5 of the Regulations. The applicant also submitted that the royalty was paid to enable the applicant to exploit the trademarks and trade names licensed to it and that it was entitled to manufacture the products on its own or outsource it to a third

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party. The respondent contended that the royalty payments did fulfill the elements prescribed under reg 5(1)(a)(iv) of the Regulations in that they were related to the imported goods and were a condition of the sale of the goods for export to Malaysia.

Held, allowing the appeal with costs:

(1) Under reg 5(1)(a)(iv) of the Regulations the transaction, value or the price paid for the goods when sold for export to Malaysia could be adjusted by adding the royalty payments in respect of the goods if, inter alia, the said payments were a condition of the sale of goods for export to Malaysia. From settled law it was clear that there is a noticeable trend towards the purposive approach in interpreting a taxing statute. Adopting such an approach it became apparent that the respondent's contention that the royalty payments were a condition of the sale of the goods for export to Malaysia because royalty payments were paid to Levi Strauss and Co by the applicant did not hold water. From the licence agreement it was clear that the applicant held the option to determine how it intended to source its products and this decision was based on purely commercial reasons (see paras 8, 16 & 19).

(2) The royalty payments were based on the net sale price of the post-importation sales and not the purchase price paid for the import of the product. Further the royalty payments were payable for all products sold irrespective of whether these products were sourced locally or imported from overseas. This was different from the customs calculation of products which was based on the purchase price paid at the point of importation. Thus, the royalty payments and the purchase price of the products purchased by the applicant were separate and independent transactions (see paras 20–21).

[Bahasa Malaysia summary

Berikutan perjanjian berlesen di antara Levi Strauss and Co dan Levi Strauss (M) Sdn Bhd ('pemohon'), yang mana adalah dalam perniagaan pembuatan barangan, pemohon diberikan hak untuk menggunakan tanda dagang tertentu dan nama dagang atas barangannya. Dalam balasan hak ini pemohon dikehendaki untuk membayar pelbagai jumlah wang ('bayaran royalti') kepada Levi Strauss and Co. Bayaran-bayaran royalti hendaklah dibayar untuk kesemua barang yang dijual oleh pemohon meskipun sama ada ia diambil di sini atau diimport dan sama ada diambil daripada pihak ketiga yang berkaitan atau tidak berkaitan. Ketua Pengarah Kastam Malaysia ('responden') melaraskan nilai kastam kesemua barangan yang dibeli oleh pemohon di antara tahun 2000 dan 2001 ('tempoh material') dengan memasukkan bayaran-bayaran royalti yang dibayar oleh pemohon kepada Levi Strauss and Co. Responden bergantung kepada peraturan 4 dan 5 Peraturan-Peraturan Kastam (Kaedah Penilaian) 1999 ('Peraturan-Peraturan') untuk mencapai nilai

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kastam yang diselaraskan terhadap barang-barang yang dibeli oleh pemohon untuk tempoh material tersebut. Pemohon memfailkan permohonan semakan kehakiman terhadap keputusan responden untuk mengenakan duti kastam tambahan sejumlah RM3,699,706.71 dan cukai jualan tambahan sejumlah RM2,219,824.02 atas barang-barang yang dibeli oleh pemohon semasa tempoh material tersebut. Pemohon berhujah bahawa bayaran-bayaran royalti tidak patut dimasukkan di dalam pengiraan nilai kastam barangan yang dibeli oleh pemohon kerana ia bukan syarat untuk pemohon untuk menjual barang-barang di Malaysia, seperti yang dikehendaki di bawah peraturan 5 Peraturan-Peraturan. Pemohon juga berhujah bahawa royalti dibayar untuk membolehkan pemohon mengeksploitasikan tanda dagang dan nama dagang yang diberikan kepadanya dan bahawa ia berhak untuk membuat barang-barang dengan sendirinya atau memberikanya kepada pihak ketiga. Responden berhujah bahawa bayaran-bayaran royalti tidak memenuhi usur-unsur yang dinyatakan di bawah peraturan 5(1)(a)(iv) Peraturan-Peraturan dengan itu ia adalah berkaitan kepada barang-barang yang diimport dan adalah syarat jualan barang-barang untuk mengeksport ke Malaysia.

Diputuskan, membenarkan rayuan dengan kos:

(1) Di bawah peraturan 5(1)(a)(iv) Peraturan-Peraturan nilai transaksi atau harga yang dibayar untuk barang-barang apabila dijual untuk eksport ke Malaysia boleh diselaraskan dengan menambahkan bayaran-bayaran royalti berkaitan barang-barang jika, antara lain, bayaran-bayaran tersebut adalah syarat jualan barang-barang untuk ekspot ke Malaysia. Daripada undang-undang yang ditetapkan adalah jelas bahawa terdapat ikutan ketara mengarah kepada pendekatan maksud dalam mentafsirkan statut cukai. Dengan mengunakan pendekatan sedemikian jelas bahawa hujahan responden yang bayaran-bayaran royalti adalah syarat jualan barang-barang untuk eksport ke Malaysia kerana bayaran-bayaran royalti dibayar kepada Levi Strauss and Co oleh pemohon adalah tidak munasabah. Daripada perjanjian berlesen adalah jelas bahawa pemohon mempunyai pilihan untuk menentukan bagaimana ia berniat untuk mendapatkan barangannya dan keputusan ini adalah berdasarkan alasan-alasan perdagangan semata-mata (lihat perenggan 8, 16 & 19).

(2) Bayaran-bayaran royalti harga jualan bersih jualan selepas pengimportan dan bukan harga belian yang dibayar untuk import barangan tersebut. Selanjutnya bayaran-bayaran royalti hendaklah dibayar untuk kesemua barangan yang dijual tidak kira sama ada barang-barang ini diambil di sini atau diimport dari luar negara. Ini adalah berlainan daripada pengiraan kastam barangan berdasarkan harga belian yang dibayar pada masa pengimportan. Oleh itu, bayaran-bayaran royalti dan harga belian barangan yang dibeli oleh pemohon merupakan transaksi-transaksi yang berbeza dan bebas (lihat perenggan 20–21).]

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Notes:

For cases on application on judicial review, see 1(1) *Mallal's Digest* (4th Ed, 2010 Reissue) paras 254–279.

For cases on purposive approval, see 11 *Mallal's Digest* (4th Ed, 2008 Reissue) paras 1819–1870.

Cases referred to

Inland Revenue Commissioners v McGuckian [1997] 1 WLR 991, HL (refd)

Marx v Inland Revenue Commissioner [1970] NZLR 182 (refd)

National Land Finance Co-operative Ltd v Director-General of Inland Revenue [1994] 1 MLJ 339; [1993] 4 CLJ 339, SC (refd)

Nike Sales Malaysia Sdn Bhd v Jabatan Kastam DiRaja Malaysia & Ors [2011] 5 MLJ 123, HC (folld)

Palm Oil Research and Development Board Malaysia & Anor v Premium Vegetable Oils Sdn Bhd [2011] 3 MLJ 97; [2004] 2 CLJ 265, FC (refd)

Stenhouse Holdings Ltd v Commissioners of Inland Revenue [1972] SLT 74 (refd)

Legislation referred to

Customs Act 1967 s 142(35B)

Customs (Rules of Valuation) Regulations 1999 regs 4, 4(1), 5, 5(1)(a)(iv)

Interpretation Acts 1948 and 1967 s 17

DP Naban (S Sravana Kumar with him) (Lee Hishamuddin Allen & Gledhill) for the applicant.

Noor Hisham Ismail (Senior Federal Counsel, Attorney General's Chambers) for the respondent.

Zawawi Salleh J:

INTRODUCTION

[1] Before the court is the applicant's application for a judicial review for the following reliefs:

(a) An order for certiorari for the purpose of quashing the decision of the respondent where the respondent had adjusted the customs value of all products purchased by the applicant for the period between year 2000 and 2002 ('material period') by including the royalty paid by the applicant to Levi Strauss & Co pursuant to a license agreement dated 1 December 1988 and the amendments thereto made on 1 December 1991 in determining the transaction value of the products purchased, and the respondent's consequent decision of imposing:

(i) a sum of RM3,699,706.71 as additional customs duty payable by the applicant on the products purchased by the applicant during the material period; and

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(ii) a sum of RM2,219,824.02 as additional sales tax on the products purchased by the applicant during the material period.

(b) All other and further relief which this honourable court deems fit and proper; and

(c) The costs of this proceedings are provided.

[2] The determinations of the respondent in adjusting the customs value and the consequent decision to impose additional sales tax and customs duty are all collectively referred to as 'the Impugned Decision'.

[3] Leave allowing this judicial review was allowed on 6 January 2009. After considering the rival submissions, the court allowed this application with costs fixed at RM8,000 for the applicant.

BACKGROUND FACTS

[4] The applicant had laid down succinctly its mode of business and it goes as follows:

(a) The applicant is in the business of manufacturing and distributing Levi's® and Dockers® apparels and accessories in Malaysia. They obtained a license agreement dated 4 April 1998 with Levi Strauss & Co ('LS&Co') which was amended on 1 December 1991. This license agreement granted them various rights and some of the rights will be elaborated later.

(b) In consideration of the right to use the trademarks and trade names, the applicant is required under the license agreement to pay LS&Co:

(i) 12% of the net sales price of all core products;

(ii) 5% of the net sales price of all non-core products sold by the applicant directly to any customer other than an affiliate of the applicant; and

(iii) an additional 1% of the net sales price of all the products sold to Levi's Shop®.

(c) The various amounts payable by the applicant are referred to as 'Royalties'. These royalty are payable for all products sold by the applicant notwithstanding whether they are sourced locally or imported and whether sourced from related or non-related third parties.

(d) The applicant procures the products either:

(i) directly from local manufacturers ie Ina Industries (M) Sdn Bhd and DNP Garment Manufacturing Sdn Bhd;

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(ii) directly from Levi Strauss Asia Pacific Division Pte Ltd;

(iii) from local third party through Levi Strauss Asia Pacific Division Pte Ltd (ie Imperial Garments Sdn Bhd);

(iv) from overseas third parties through Levi Strauss Asia Pacific Division Pte Ltd (ie MasterWorld Garment Manufacturing Ltd and Wisen Garments Ltd); and

(v) from related party through Levi Strauss Asia Pacific Division Pte Ltd (ie Levi Strauss (Phil) Inc).

[5] Things were going on smoothly for the applicant until one day when the respondent did a postimportation audit towards the applicant. The respondent decided to adjust the customs value of all products purchased by the applicant for the period between year 2000 and year 2001 by including the royalty paid by the applicant to LS&Co pursuant to a license agreement dated 1 December 1991 vide a letter dated 27 July 2007.

THE LEGAL POSITION

[6] On bare reading of s 142(35B) of the Customs Act 1967 ('Act 235'), it clearly allows the Minister of Finance to make regulations to determine the customs value of imported goods. Section 142(35B) reads:

Section142: Power to make regulations.

The Minister may make regulations;

(35B) to determine the customs value of imported goods;

[7] The regulations pertaining to the rules of valuation are detailed in the Customs (Rules of Valuation) Regulations 1999. In reg 4(1) Customs (Rules of Valuation) Regulations 1999, the customs value of imported goods shall be their transaction value. Transaction value is the price paid for the goods when sold for export to Malaysia. The relevant parts of reg 4 reads:

Regulation 4: Transaction value as primary basis of valuation

(1) The customs value of imported goods shall be their transaction value, that is, the price paid or payable for the goods when sold for export to Malaysia, adjusted in accordance with regulation 5, provided that —

(a) there are no restrictions in respect of the disposition or use of the goods by the buyer, other than restrictions that:

(i) are imposed by law;

(ii) limit the geographical area in which the goods may be resold; or

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(iii) do not substantially affect the value of the goods;

(b) the sale of the goods or the price paid or payable for the goods is not subject to some condition or consideration where its value cannot be determined;

(c) no part of the proceeds of any subsequent resale, disposal or use of the goods by the buyer is to accrue, directly or indirectly, to the seller; or

(d) the buyer and seller of the goods are not related at the time the goods are sold for export or where the buyer and seller are related at that time but the proper officer of customs is satisfied that their relationship did not influence the price paid or payable for the goods.

(3) In any case where the proper officer of customs is of the opinion that the relationship between the buyer and seller of any goods influenced the price paid or payable for the goods, the proper officer of customs shall inform the buyer, in writing if so requested, of the grounds on which the proper officer of customs formed that opinion, and shall give the buyer a reasonable opportunity to satisfy the proper officer of customs that the relationship did not influence the price.

[8] Regulation 5(1)(a)(iv) on the other hand, allows the transaction value to be adjusted by adding the royalties paid in respect of the goods, inter alia, if it forms a condition that the sale of the foods are for export to Malaysia. The relevant portion of reg 5 reads:

Regulation 5: Adjustment of price paid or payable

(1) *In determining the transaction value of imported goods under regulation 4, the price paid or payable for the goods shall be adjusted —*

(a) by adding thereto amounts, where such amount is not already included in the price paid or payable for the goods, determined on the basis of sufficient information, equal to:

(i) ...

(ii) ...

(iii) ...

(iv) royalties and license fees, including payments for patents, trademarks and copyrights in respect of the goods that the buyer must pay, directly or indirectly, as a condition of the sale of the goods for export to Malaysia, exclusive of charges

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for the rights to reproduce the goods in Malaysia;

THE APPLICANT'S CASE

[9] The applicant submitted that there are a few elements of reg 5(1)(a)(iv) that must be complied and they are as follows:

(a) there must be royalty payment;

(b) royalty must be in respect of the goods imported to Malaysia;

(c) royalty must be paid by the buyer directly or indirectly, as a condition of the sale of the goods for export to Malaysia; and

(d) exclude royalty for the rights to reproduce the goods in Malaysia.

[10] The nub of the applicant's submission was that the royalty payment paid by the applicant to LS&Co according to the license agreement dated 1 December 1991 are not a condition for the applicant to sell the products in Malaysia. This means that the elements in reg 5 of the Customs (Rules of Valuation) Regulations 1999 are not fulfilled.

[11] The applicant further submitted that the royalty was paid to enable the applicant to exploit the trademarks and trade names licensed to the applicant. The applicant was entitled to manufacture the products on its own or they could outsource it to a third party. The consideration to outsource was based on pure commercial reasons and was not because they were required or conditioned to do so. There was no contractual requirement on the applicant to appoint related parties to manufacture the products.

[12] The respondent on the other hand submitted that the payment of royalty did fulfill the elements prescribed under reg 5(1)(a)(iv) of the Customs (Rules of Valuation) Regulations 1999 which are:

(a) the royalty is related to the imported goods; and

(b) rhe royalty is a condition of the sale of the foods for export to Malaysia.

[13] The respondent is of the view that according to the license agreement and the amendments thereto, royalty needs to be paid for all of the products that is sold by the applicant notwithstanding if the product was locally sourced or imported from another country and notwithstanding that the product was bought by parties affiliated to the applicant or otherwise. The respondent interpreted that the products imported by the applicant fulfilled the two elements of rights that was given by LS&Co to the applicant with the payment

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of royalty by the applicant to LS&Co as its consideration. The two elements are:

(a) The right to stick/use the trademark and commercial name belonging to LS&Co to the said products.

(b) The right to use technical date belonging to LS&Co in the creation of the products.

[14] The issue of law that the court needs to decide is whether the import transaction made by the applicant allows the respondent to use additional royalty to the transaction value of imported goods according to reg 5(1)(a)(iv) of the Customs (Rules of Valuation) Regulations 1999.

THE PRINCIPLES IN INTERPRETING A TAXING STATUTE

[15] Firstly, it is necessary to lay down the approach that this court takes in dealing with the interpretation of a provision of an Act. Gunn Chit Tuan CJ (Malaya) in *National Land Finance Co-operative Ltd v Director General of Inland Revenue* [1994] 1 MLJ 99; [1993] 4 CLJ 339, a Supreme Court decision, laid down the three principles in construing the interpretation of taxing statutes. He said:

> Firstly, there is no room for intendment in tax legislation and the rule of strict construction applies. Unless there are clear words tax cannot be imposed (per Rowlatt J in *Cape Brandy Syndicate v IRC* 12 TC 358). Another principle is that where the meaning of a statute is in doubt the ambiguity must be construed in favour of the subject. Yet another principle is that an exemption from tax cannot be removed except by sufficiently clear words to achieve that purpose.

[16] There is a noticeable trend towards purposive approach in interpreting a taxing statute (see *Inland Revenue Commissioners v McGuckian* [1997] 1 WLR 991 and *Stenhouse Holdings Ltd v Commissioners of Inland Revenue* [1972] SLT 74). The purposive approach has long been recognised by Malaysian Law as part of the rule in interpreting legislation. Section 17 of the Interpretation Acts 1948 ('Act 388') provides:

Section 17A: Regard to be had to the purpose of Act

> In the interpretation of a provision of an Act, a construction that would promote the purpose or object underlying the Act (whether that purpose or object is expressly stated in the Act or not) shall be preferred to a construction that would not promote that purpose or object.

[17] In *Palm Oil Research and Development Board Malaysia & Anor v*

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Premium Vegetable Oils Sdn Bhd [2005] 3 MLJ97; [2004] 2 CLJ 265 Gopal Sri Ram JCA (as he then was) had this to say about interperating a taxing statute:

> First, the words are to be given their ordinary meaning. They are not to be given some other meaning simply because their object is to frustrate legitimate tax avoidance devices. As Turner J said in his (albeit dissenting) judgment in *Marx v Inland Revenue Commissioner* [1970] NZLR 182 at p 208,moral precepts are not applicable to the interpretation of revenue statutes.
>
> Secondly, ' in … one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption so to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used.' (Per Rowlatt J in *Cape Brandy Syndicate v Inland Revenue Commissioners* [1921] 1 KB 64 at p 71, approved by Viscount Simons LC in *Canadian Eagle Oil Co Ltd v Regeim* [1945] 2 All ER 499; [1946] AC 119).
>
> Thirdly, the object of the construction of a statute being to ascertain the will of the legislature, it may be presumed that neither injustice nor absurdity was intended. If therefore a literal interpretation would produce such a result, and the language admits of an interpretation which would avoid it, then such an interpretation may be adopted.
>
> Fourthly, the history of an enactment and the reasons which led to its being passed may be used as an aid to its construction.
>
> In my respectful view, s 17A of the Interpretation Acts 1948 and 1967neatly fits into and is complementary with the third principle in the judgment of Lord Donovan. *Hence, the governing principle is this. When construing a taxing or other statute, the sole function of the court is to discover the true intention of Parliament. In that process, the court is under a duty to adopt an approach that produces neither injustice nor absurdity: in other words, an approach that promotes the purpose or object underlying the particular statute albeit that such purpose or object is not expressly set out therein* (Emphasis added.)

THE COURT'S FINDING

[18] The issue before the court is whether the respondent should charge additional royalty to the transaction value of imported goods in accordance to reg 5(1)(a)(iv) of the Customs (Rules of Valuation) Regulations 1999.

[19] With respect, the respondent's contention that the royalty was a condition of the sale of the goods for export to Malaysia because royalty was paid to LS&Co by the applicant does not hold water. The license agreement does not contain any provision requiring the applicant to source for the products from any related parties. It does not make any reference or condition in relation to purchase of the products by the applicant. The applicant holds the option to determine how it intended to source its products. The decision to choose the source was a pure commercial reasons such as to achieve better costing through economics of scale, price, commercial friendliness, quality and consistent quality of the products.

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[20] The royalty was based on the net sale price of the post- importation sales and not the purchase price paid for the import of the product. The royalty is also payable for all products sold irrespective of whether these products were sourced locally or imported from overseas. This is different from the customs calculation of products which is based on the purchase price paid at the point of importation. In fact, the royalty was also paid for the right to reproduce the products in Malaysia and this is expressly excluded under reg 5(1)(a)(iv).

[21] To my mind, what seems to be clear is that the royalty and the purchase price of the products purchased by the applicant are separate and independent transactions.

[22] The most recent case which had similar bearings to this case is the unreported decision of my learned brother YA Tuan Mohamad Ariff Md Yusof in *Nike Sales Malaysia Sdn Bhd v Jabatan Kastam DiRaja Malaysia & Ors* [2011] 5 MLJ 123; Originating Summons No R3(1)–25–03 of 2004). In this case, Nike Sales Malaysia ('Nike') filed a judicial review against the decision of the Jabatan Kastam DiRaja Malaysia (which is also the respondent in this case) against the demand by the respondent for the payment of RM3,292,076.91 as customs duties and sales tax payable by Nike Malaysia under the same regulation ie reg 5(1)(a)(iv) of the Customs (Rules of Valuation) Regulations 1999.

[23] In that case, the learned judge had taken the task and had gone in intrinsic detail in explaining the jurisprudence underlying the reg 5(1)(a)(iv) of the Customs (Rules of Valuation) Regulations 1999 with reference to authorities in Malaysia, Canada, Australia and New Zealand just to name a few. He even cited the advisory opinions of the technical committee on customs valuation established under the WTO Valuation Agreement called the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994, of which Malaysia is a signatory.

[24] The court in that case allowed the appeal and concluded that if the Parliament had intended that royalty paid in relation to an export of goods be regarded as an adjustment item for the purposes of calculating customs value, there will be no need to further provide for the conditions in reg5(1)(a)(iv) of the Customs (Rules of Valuation) Regulations 1999. Be that as it may, the court in that case was minded that it was indeed necessary to consider both economic reality and the legal relationship underlying the business transaction flow on the facts of that case.

[25] The court finds no reason to differ from the above decision. The court is persuaded that His Lordship's decision is correct.

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[26] The respondent tried to distinguish the case with the facts of the present case stating that the conclusion arrived in that case is peculiar to its own facts. This court however disagrees and is of the considered view that the *Nike Sales Malaysia Sdn Bhd v Jabatan Kastam DiRaja Malaysia & Ors* is indeed a relevant case to be referred to as the issues before it are more or less similar to the issues in this case.

[27] Finding much support from the *Nike Sales Malaysia Sdn Bhd v Jabatan Kastam DiRaja Malaysia & Ors* case and for the reasons above stated, the court is of the opinion that this appeal ought to be allowed with costs.

Appeal allowed with costs.

Reported by Kohila Nesan